No. 383

In the Supreme Court of the United States

OCTOBER TERM, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GEORGE B. CLIFFORD, JR.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

INDEX

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The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Eighth Circuit, entered in the above entitled cause on July 24, 1939, reversing the decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 10-17) is unreported. The opinion of the Circuit Court of Appeals (R. 70) has not yet been reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 24, 1939 (R. 76). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer in 1934 declared himself trustee of certain property to pay the net income therefrom to his wife or to hold or accumulate it in his discretion, the trust to terminate at the expiration of five years or upon the earlier death of taxpayer or his wife, whereupon the corpus was to be restored to the grantor or his estate but any undistributed net income was to be treated as the property of the wife. Was the net income of the trust for 1934 properly included in the taxpayer's gross income?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 11–17.

STATEMENT

The material facts as found by the Board of Tax Appeals (R. 10–16) and stipulated by the parties (R. 30–38) may be summarized as follows:

On June 20, 1934, the respondent declared himself trustee of certain securities (R. 10). The trust was to terminate upon the expiration of five years or upon the earlier death of himself or his wife. Upon termination the corpus was to

"be deemed and treated as property owned absolutely by" the grantor (R. 11).

During the continuance of the trust the grantor, as trustee, retained the right to distribute to his wife, Virginia R. Clifford, the whole or such part of the net income [1] of the trust as he in his absolute discretion should determine. But any accrued or undistributed income remaining upon termination of the trust was to be treated as property owned absolutely by his wife (R. 11).

The grantor retained plenary control over the corpus of the trust, such as the power to sell, exchange, mortgage, or pledge any of the property upon terms and conditions subject only to his absolute discretion, to appoint proxies to exercise voting rights, to make investments without limitation of any laws pertaining to the investment of trust funds, and to settle any claims (R. 11–12). He exonerated himself from any liability as trustee except for "wilful and deliberate" misconduct (R. 12). And, except as provided above, no title in or to the trust estate or any income therefrom was to vest in his wife; neither the principal nor any undistributed income was to be chargeable for her debts; and she was to have no power to encumber

[1] However, the trust instrument provided that (R. 12):

"5. Extraordinary cash dividends, any dividends paid in stock or the proceeds received from sale of any subscription rights not exercised, or any enhancement, realized or not, in the value of securities shall be considered and treated as principal and not income."

or to dispose of any rights or income prior to actual payment to her (R. 12–13).

The net income of the trust for the year 1934 was $10,111.23 which included $1,160.96 capital gain (R. 16). The grantor did not report any of the trust income in his own returns (R. 15). The Commissioner determined a deficiency by adding the trust income to the taxpayer's personal income. The Board of Tax Appeals approved, but the Circuit Court of Appeals reversed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the trust income here involved was not taxable to the respondent under Section 166 of the Revenue Act of 1934.

(2) In holding invalid Article 166–1 of Treasury Regulations 86 as applied to the facts herein.

(3) In holding that the income involved was not taxable to the respondent under Section 22 (a) of the Revenue Act of 1934.

(4) In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. This case presents an important question of federal income taxation, in which the court below not only nullified an attempt by Congress to correct a loophole existing under earlier statutes, but also invalidated the applicable Treasury Regulations.

Experience had shown that a device frequently employed by taxpayers attempting to avoid surtaxes was to create trusts providing for the distribution of income in a predetermined manner satisfactory to the grantor and in which the grantor retained rights in or varying degrees of control over the corpus. To meet this situation, Congress in 1924 provided that where the grantor "has, at any time during the taxable year, * * * the power to revest in himself title to any part of the corpus, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor." Section 219 (g) of the Revenue Act of 1924.[2]

Taxpayers immediately attempted to circumvent these and successor provisions by creating trusts which were to terminate beyond the taxable year or in which the power to revoke could be exercised only upon notice given more than a year in advance. And relying upon the phrase "during the taxable year," the courts held that the income from such trusts was not taxable to the grantor. *Langley* v. *Commissioner*, 61 F. (2d) 796 (C. C. A. 2d), Judge A. N. Hand dissenting; *Lewis* v. *White*, 56 F. (2d) 390 (Mass.), appeal dismissed, 61 F. (2d) 1046 (C. C. A. 1st).

In response to that interpretation of the statute, Congress amended the revenue law in 1934 by elim-

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[2] C. 234, 43 Stat. 253. These provisions were applied and sustained in *Corliss* v. *Bowers*, 281 U. S. 376, and *Reinecke* v. *Smith*, 289 U. S. 172.

inating the words "during the taxable year" and "for such taxable year." Revenue Act of 1934, Section 166, *infra*. As thus amended, the Act provided for the taxing of such income to the grantor where he *at any time* was entitled to revest the corpus in himself.[3]

Article 166–1 of Regulations 86, issued under the Revenue Act of 1934, thereupon made it clear that the grantor is taxable where the trust is no more than an arrangement whereby he entrusts to a fiduciary the title to and management of his property for a fixed period to distribute the income in the way in which he chooses to commit himself in advance, while the corpus is to be held intact for return in due course to himself. "In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposi-

[3] In explaining this change in the law, the Conference Report relating to the bill which became the Revenue Act of 1934 stated (H. Rep. No. 1385, 73d Cong., 2d Sess., p. 24):

"Amendments nos. 96 and 97: Under existing law, the income from a revocable trust is taxable to the grantor only where such grantor (or a person not having a substantial adverse interest in the trust) has the power within the taxable year to revest in the grantor title to any part of the corpus of the trust. Under the terms of some trusts, the power to revoke cannot be exercised within the taxable year, except upon advance notice delivered to the trustee during the preceding taxable year. If this notice is not given within the preceding taxable year, the courts have held that the grantor is not required under existing law to include the trust income for the taxable year in his return. The Senate amendments require the income from trusts of this type to be reported by the grantor. The House recedes."

tion or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for a specified period." Article 166–1, Regulations 86, *infra.*

Substantially the same provisions appeared thereafter in Article 166–1 of Regulations 94 and 101 promulgated under the Revenue Acts of 1936 and 1938, respectively,[4] which reenacted the relevant statutory provisions without change.[5] Under the familiar rule these regulations should be treated as having received legislative sanction. *Taft* v. *Commissioner,* 304 U. S. 351, 357.

The trust in the instant case was limited to a duration of five years, at the expiration of which the corpus was to "be deemed and treated as property owned absolutely by" the taxpayer (R. 11). The grantor's rights were no less than he would have had by creating a trust to last for a longer period but reserving a complete right of revocation at the end of five years.[6] In either event, the

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[4] C. 690, 49 Stat. 1648; c. 289, 52 Stat. 447.

[5] Moreover, Congress also enacted, without making any change in these provisions, the Revenue Acts of 1935, 1937, and 1939. C. 829, 49 Stat. 1014; c. 815, 50 Stat. 813; Public, No. 155, 76th Cong., 1st Sess.

[6] Compare *Du Pont* v. *Commissioner*, 289 U. S. 685, where irrevocable trusts to pay premiums on policies of insurance on the grantor's life were to last for a period of three years, at the end of which they might be extended for a similar period. In holding valid the provisions of the statute which required the grantor to account for the income of the trusts, the Court said (pp. 688–689):

"* * * Here the grantor did not divest himself of title in any permanent or definitive way, did not strip himself

statute requires the income to be taxed to the grantor and the holding of the court below to the contrary plainly invalidates the Treasury regulations which so construe the statute.[7]

While there is no conflict of decisions among the Circuit Courts of Appeals on this issue, the question is nevertheless one of great importance because the decision below nullifies the applicable Treasury Regulations and throws into confusion the administration of the tax laws in this regard. We are informed by the Treasury Department that there are now pending at least forty-three cases presenting the same issue, involving an aggregate tax liability of approximately $1,300,000.

2. An additional ground for the imposition of the tax, wholly apart from the trust provisions in Sec-

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of every interest in the subject matter of the trust estate. During a term of three years, the trustee was to apply the income to the preservation of the policies, and while thus applying the income was to hold the principal intact for return to the grantor unless instructed to retain it longer. The situation in its legal effect would not be greatly different if the trusts had been created for a month or from day to day. * * *"

It is particularly noteworthy that the four Justices who dissented in the companion case of *Burnet* v. *Wells*, 289 U. S. 670, where a similar trust was to last throughout the life of the grantor, concurred in result in the *Du Pont* case because of the short-term character of the trusts.

[7] *Blair* v. *Commissioner*, 300 U. S. 5, heavily relied upon both by the taxpayer and the court below did not involve the application of Section 166 or the regulations promulgated thereunder. Moreover, the assignor of the income in that case was never the owner of the underlying property which produced it.

tion 166, is that the instant case falls within the decisions holding that an assignment of future income either from earnings or from property owned by the assignor does not relieve him of liability for tax. This case presents a substantial conflict in principle with those decisions. *Lucas* v. *Earl,* 281 U. S. 111 (earnings from services); *Burnet* v. *Leininger,* 285 U. S. 136 (partnership profits); *Harris* v. *Commissioner,* 39 F. (2d) 546 (C. C. A. 2d) (partnership profits); *Rossmore* v. *Commissioner,* 76 F. (2d) 520 (C. C. A. 2d) (partnership profits); *Ward* v. *Commissioner,* 58 F. (2d) 757 (C. C. A. 9th) (rents); *Rosenwald* v. *Commissioner,* 33 F. (2d) 423, 426 (C. C. A. 7th), certiorari denied, 280 U. S. 599 (rents); *Bing* v. *Bowers,* 22 F. (2d) 450, 454 (S. D. N. Y.), affirmed 26 F. (2d) 1017 (C. C. A. 2d) (income from property). The significant factor in the foregoing cases of assignments of income from property or property rights is that since the assignor failed to dispose of the underlying property or property rights which produced the income, he could not by anticipatory arrangements deflect such income for tax purposes.

The instant case presents substantially the same issue. The taxpayer merely relinquished in advance the income from his property for a period of five years, without in any way parting with the principal. True, he accomplished this by means of a trust. But, in its essentials, the mechanism adopted did not differ from a simple assignment of

income for a fixed period.* And in *Balkwill* v. *Commissioner*, 77 F. (2d) 569 (C. C. A. 6th), certiorari denied, 296 U. S. 609, it was held that even though the assignment is attempted through the medium of a trust, the general rule nevertheless obtains and the grantor remains accountable for the income. The decision below is therefore in substantial conflict with this line of cases.

Under those decisions the assigned income is treated as gross income of the assignor, and the income here must likewise be included in the taxpayer's gross income which is broadly defined in Section 22 (a). He may not contend that, since he has established a trust, he must be taxable, if at all, only under the trust provisions of the statute, for it has been established that the trust provisions and Section 22 (a) are not mutually exclusive. *Douglas* v. *Willcuts*, 296 U. S. 1, 10.

CONCLUSION

It is therefore respectfully submitted that this petition for a writ of certiorari should be granted.

ROBERT H. JACKSON,
Solicitor General.

SEPTEMBER 1939.

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* The similarity is strikingly illustrated here by the fact that the grantor was also the trustee and had at least as much power in dealing with the corpus as an assignor might have with respect to property the income from which he had assigned.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *. (U. S. C., Title 26, Sec. 22.)

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor. (U. S. C., Title 26, Sec. 166.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or—

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question." (U. S. C., Title 26, Sec. 167.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 166-1 [as amended by T. D. 4629, XV-1 Cum. Bull. 140, 141 (1936), and T. D. 4759, 1937-2 Cum. Bull. 117, 118].

Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.—(*a*) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(*b*) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession

and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those

which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(*c*) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for

a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(*d*) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership

in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

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